Roll Call

# Lawmakers plan further probe of trading models in GameStop saga

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Robinhood CEO made 'startling' disclosures at first hearing

Lawmakers are vowing to keep pressure on Robinhood Markets Inc. after what they say are unsatisfactory answers from the online investment app's CEO, Vlad Tenev, during a hearing last month examining the GameStop Corp. trading volatility.

Members of the House Financial Services Committee told CQ Roll Call they're examining whether the online broker's business model is compatible with its obligation to protect investors. The panel will convene again March 17 for the second of three planned hearings to examine the GameStop frenzy.

Democrats on the panel in particular say they plan to pursue additional lines of inquiry, such as how the company may be enticing customers by offering commission-free trading.

"Having a zero-commission model creates a circumstance where the incentives are to take advantage of people," Rep. Sean Casten, D-Ill., told CQ Roll Call. The longtime Robinhood critic said he is "dubious" that the broker can satisfy the Securities and Exchange Commission's best execution standards while getting paid to route customer trades to bigger Wall Street firms.

The company has faced growing scrutiny after it paused purchases of GameStop and other stocks. Committee members during the hearing peppered Tenev with questions about the company's reliance on payments it receives from Wall Street firms for funneling customer trades to them for execution.

Robinhood's use of payment-for-order-flow arrangements with bigger Wall Street firms, known as market makers, allows the company to offer zero-commission trades. Market makers offer to buy and sell securities and make money off the difference in the spread between the two prices. More than half the company's revenue comes from those payments, Tenev told lawmakers.

Unlike competitors who get paid by the number of trades they send to market makers, Robinhood gets a percentage of the spread. Casten said that dynamic, which he called one of the biggest revelations of the hearing, creates a conflict of interest.

"If you have structured your contract to make money based on the bid-ask spread … you have a vested interest and economic interest in bringing unsophisticated customers to the market makers, right? Because that's how you make more money," he said.

### 'Marketing gimmick'

Todd Cipperman, founder of Cipperman Compliance Services, called zero-commission trading a "marketing gimmick." Cipperman's firm works with investment advisers, which are subject to stricter investor protection standards than brokers, although they often find themselves in competition with one another for customers.

"I see payment for order flow as an unsolvable conflict of interest," Cipperman said. "I would severely limit it and perhaps prohibit it. I don't see in any way, shape or form how this helps retail investors and traders."

Retail investors end up paying for the trades they place through lower-quality execution of those transactions, they just don't realize it, Cipperman said in an interview.

In theory, payment for order flow shouldn't impede the best execution of customer's trades. However, there have been enough incidents to cause concern, he said. Robinhood paid $65 million in December to settle SEC charges that it had cost customers more than $34 million for allegedly failing to secure the best available execution of users' trades. The company neither admitted nor denied the agency's findings.

Jennifer Schulp, director of financial regulation studies at the Cato Institute, cautioned against eliminating payment for order flow, which she said has drawn a new set of investors to the market through lowered trading costs.

"Stock ownership is highly correlated with wealth, age and race, and education in this country. The people that started trading in 2020 are more diverse than that. They have lower incomes," she said. "Not only is it good for our markets, but it's good for people to have access to investments in our stock markets. It's a good way for people to grow long-term wealth, and it's good to start that young."

At the same time, retail investors should understand how their broker is making money, she said, suggesting better disclosure could be the answer.